



CITY OF LAGUNA HILLS

2018 INVESTMENT & PORTFOLIO POLICIES





Investment and Portfolio Policies Calendar Year 2018

TABLE OF CONTENTS

I.	Policy	1
II.	Scope	1
III.	Objectives.....	1
IV.	Standards of Care.....	3
V.	Safekeeping and Custody	4
VI.	Authorized and Suitable Investments.....	5
VII.	Competitive Selection of Investment Instrument.....	7
VIII.	Reporting.....	7
IX.	Annual Investment Policy and Adoption.....	8

**CITY OF LAGUNA HILLS
INVESTMENT AND PORTFOLIO POLICIES
2018**

I Policy

It is the Policy of the City of Laguna Hills to invest in a manner, which will ensure the safety of public funds by mitigating credit and interest rate risk, and provide sufficient liquidity to meet all operating requirements. The City shall also strive to attain a return on investment that is reasonable given that safety of principal and liquidity are the primary objectives in these policies and yield is secondary. The investment program shall be operated in conformity with federal, state and other legal requirements, including the State of California Government Code Section 53601, et, seq., these policies and written administrative procedures.

II Scope

This investment policy applies to the investment of all funds of the City and the City of Laguna Hills Public Improvement Corporation, including the following:

- General Fund
- Special Revenue Funds
- Capital Projects Funds
- Funds Held Under Trust Indenture

These funds are accounted for in the City's Comprehensive Annual Financial Report.

Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

Investments under the trust indenture will be held separately and made in accordance with the indenture requirements.

III Objectives

Funds of the City will be invested, by the City Treasurer, or authorized deputies of the Treasurer (hereinafter collectively referred to as "the Treasurer") in accordance with these policies and written administrative procedures. The primary objectives, in priority order, of investment activities shall be:

1) Safety

Safety of principal is the foremost objective of the City's investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio and the mitigation of credit risk and interest rate risk.

a) Credit Risk

Credit Risk is the risk of loss due to the failure of the security issuer or backer. Credit Risk may be mitigated by:

**CITY OF LAGUNA HILLS
INVESTMENT AND PORTFOLIO POLICIES
2018**

- i. limiting investments to the safest types of securities listed under Section VI herein, which shall be limited to those investments backed by the U.S. Government, or an agency thereof, overnight accounts managed by the City's primary bank, the Local Agency Investment Fund (LAIF), and other specific investments described in Section VI;
- ii. diversifying the portfolio to avoid concentration of securities from a specific issuer, except issuers of U.S. Treasury securities, so that the failure of any one issuer will not place an undue financial burden on the City;
- iii. monitoring all of the City's investments on a frequent basis to anticipate and respond accordingly to a significant reduction of creditworthiness of any of the depositories, including the City's primary bank; and
- iv. performing appropriate due diligence to assure the credit worthiness of any portfolio investment made.

b) *Interest Rate Risk*

Interest rate risk is the risk that the market value of securities in the portfolio will fall due to changes in general interest rates. To reduce interest rate risk, the City shall limit the maximum maturity horizon of the securities that comprise its portfolio, keeping in mind that the longer the maturity horizon, the greater the price volatility. In accordance with the Government Accounting Standards Board reporting requirements, the portfolio could show unrealized gains or losses for any reporting period.

Interest rate risk may be mitigated by:

- i. structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity; and
- ii. investing operating funds primarily in shorter-term securities.

2) Liquidity

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity) and a portion of the portfolio should be invested in readily available funds, to ensure that appropriate liquidity is maintained to meet ongoing obligations.

3) Yield

The rate of return on the City's investment portfolio is of secondary importance to the safety and liquidity objectives described above. The City's investment strategy is passive and investments are limited to relatively low-risk securities in anticipation of earning a rate of return throughout

budgetary and economic cycles, commensurate with the City's investment risk constraints and the cash flow characteristics of the portfolio.

The yield shall be designed to attain an average rate of return through market cycles. Although no "benchmark" rate of return is assumed, the portfolio's yield shall be compared for reporting purposes to LAIF and the 3-month bank CD rate published by the Federal Reserve. These indices are considered benchmarks for lower risk investment transactions and therefore represent a comparable minimum standard for the portfolio's rate of return.

IV Standards of Care

1) Prudence

The City's investment portfolio is subject to public scrutiny and review and should be managed with due care and consideration. The portfolio should be created and maintained with the professionalism and care worthy of the public trust.

The standard of prudence to be applied to the Treasurer shall be the "prudent investor rule", which states, "when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, a trustee (the governing body or Treasurer) shall act with care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The Treasurer, acting in accordance with written procedures and exercising due diligence, shall not be held personally responsible for a specific security's credit risk or market price changes, provided that these deviations are reported immediately and that appropriate action is taken to control adverse developments.

2) Ethics and Conflict of Interest

Employees of the City shall refrain from personal business activity that could conflict with the proper execution of the investment program, or which could impair their ability to make impartial investment decisions. State law, City statutes, and City personnel and purchasing practices shall be followed to avoid conflict of interest or the appearance thereof. Employees shall disclose any financial interests or personal relationships with any financial institutions, brokers or securities dealers that conduct business within its jurisdiction, and any personal financial/investment positions that could be related to their management of the portfolio. The Treasurer shall be prohibited from doing business with any broker or securities dealer with whom the City does business, with the exception of the City's primary bank for banking services. Employees shall subordinate their personal investment transactions to those of the City, particularly with regard to the time of purchases and sales.

3) Delegation of Authority

Authority to manage the City's investment program is delegated to the City Treasurer by Resolution of the City Council of the City of Laguna Hills, California. Management responsibility is hereby delegated to the Assistant City Manager/Deputy Treasurer under the direction of the City Treasurer.

The Deputy Treasurer shall establish written procedures for the operation of the investment program consistent with this investment policy, together with a system of internal controls to regulate the activities of subordinates.

V Safekeeping and Custody

1) Authorized Financial Institutions, Depositories and Brokers/Dealers

Investment transactions will be undertaken with securities dealers, brokers and depositories authorized to provide investment services. In addition, the City shall maintain a "Qualified Institution" list of approved security broker/dealers selected by creditworthiness, including the minimum capital requirement of \$10 million and at least five years of operation. The City shall conduct periodic evaluations, or whenever deemed necessary, of each financial institution's standing to determine whether it should remain on the "Qualified Institution" listing. Securities dealers not affiliated with a bank shall be required to be classified as reporting dealers affiliated with the New York Federal Reserve Bank, as primary dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule).

All financial institutions and brokers/dealers who desire to become qualified for investment transactions with the City must supply the following:

- 1) Audited financial statements demonstrating compliance with State and Federal capital adequacy guidelines. Audited financial statements will be submitted annually to the City.
- 2) Proof of National Association of Securities Dealers (NASD) certification, except for counterparties in Certificates of Deposits transactions.
- 3) Proof of State Registration
- 4) Completed broker/dealer questionnaire, except for Certificates of Deposits counterparties.
- 5) Certification of having read and understood and agreeing to comply with the City's Investment Policies, as well as to disclose potential conflicts or risks to public funds that might arise out of business transactions between the firm/depository and the City.
- 6) Evidence of adequate insurance coverage.

In addition, all financial institutions shall agree to undertake reasonable efforts to preclude imprudent transactions involving the City's funds. The supervising officer shall agree to exercise due diligence in monitoring the activities of other officers and subordinate staff members engaged in transactions with the City. Employees of any firm or financial institution offering securities or

**CITY OF LAGUNA HILLS
INVESTMENT AND PORTFOLIO POLICIES
2018**

investments to the City shall be trained in the precautions appropriate to public-sector investment and shall be required to familiarize themselves with the City's Investment and Portfolio Policies.

2) Internal Control

Treasurer shall establish a system of written internal control policies and procedures, which shall be reviewed annually by the independent auditor. The controls shall be designed to prevent loss of public funds due to fraud, error, misrepresentation, unanticipated market changes or imprudent actions.

3) Delivery vs. Payment

All trades where applicable will be executed by delivery vs. payment (DVP). This ensures that securities are deposited in the eligible financial institution prior to the release of funds. A third party custodian or the trust department of the City's primary bank will hold securities. Evidence of safekeeping shall be in the form of safekeeping receipts and monthly statements reporting the securities held by the institution.

VI Authorized and Suitable Investments

1) Investment Types

Investment of City funds are restricted to the following instruments that shall mature within one year from the time of purchase unless otherwise stated:

- a) U.S. Treasury bills.
- b) U.S. Treasury notes or bonds.
- c) Insured or fully collateralized certificates of deposit issued by a qualified Public Depository Institution of the State of California.
- d) Money market mutual funds whose portfolios consist entirely of U.S. government securities and are rated at the highest letter or numerical rating from at least two of the three largest nationally recognized rating services, or which retain an Investment advisor meeting requirements specified in Government Code Section 53601(k)(2).
- e) State Treasurer's Local Agency Investment Fund.
- f) Overnight Government Securities (U.S. Treasuries, Agencies, and Instrumentalities) Investment Account managed by the City's primary bank.
- g) Overnight Commercial Paper Investment Account managed by the City's primary bank.
- h) Overnight repurchase agreements managed by the City's primary bank where the market value of the securities underlying the repurchase agreement is 102 percent or greater than the value of funds borrowed.
- i) Commercial Paper rated a minimum of "P-1" by Moody's and "A-1" by Standard and Poor's, or equivalent, as provided by a nationally recognized rating agency, maturing not more than 180 days after the date of purchase. The issuer is a corporation organized and operating in the United States with assets in excess of \$500 million.

**CITY OF LAGUNA HILLS
INVESTMENT AND PORTFOLIO POLICIES
2018**

- j) Prime Bankers' Acceptances with a maximum term of 270 days and a rating of "P-a" by Moody's and "A-1 +" by Standard and Poor's or equivalent as provided by a nationally recognized rating agency issued within the U.S. by depository institutions.
- k) Investment Trust of California, a Joint Powers Authority, doing business as CalTRUST

In all instances, the City will not purchase the aforementioned instruments by the use of leveraged or margin accounts or by taking short positions in any investment instrument; i.e., selling investments the City does not own.

Investments of funds held under a trust indenture may have maturities up to two years in duration.

2) Portfolio Diversification

The City will diversify use of investment instruments to avoid incurring unreasonable risks inherent in over investing in specific instruments, individual financial institutions or maturities.

<u>DIVERSIFICATION BY INVESTMENTS</u>	Maximum Percent of Portfolio
U.S. Treasury Obligations (bills, notes and bonds)	50%
Certificates of Deposit (CDs) Commercial Banks	50%
Certificates of Deposit (CDs) Savings and Loan	25%
State Treasurer's Local Agency Investment Fund	75%
CalTRUST	75%
Overnight investment accounts managed by City's primary bank	50%
Commercial Paper	10%
Banker's Acceptances	15%
Money Market Mutual Funds	15%

<u>DIVERSIFICATION BY INSTITUTION/ISSUER</u>	Maximum Percent of Portfolio
Certificates of Deposit (CDs) Commercial Banks	25%
Certificates of Deposit (CDs) Savings and Loan	\$250,000 maximum

3) Maximum Maturities

Investment maturities for operating funds shall be scheduled to coincide with projected cash flow needs, taking into account large routine expenditures as well as considering sizable blocks of anticipated revenue.

4) Collateralization

Collateralization will be required on repurchase agreements in order to anticipate market changes and provide a level of security for all funds.

For certificates of deposits greater than \$250,000, collateral will be required at 110% of principal for government securities collateral, and 150% of principal for first mortgage collateral. Certificates of deposits for \$250,000 or less, inclusive of earned interest at maturity may be invested in any FDIC insured commercial bank or savings and loan accounts.

Collateral will always be held by an independent third party, or the trust departments of the City's primary bank. A clearly marked evidence of ownership, such as safekeeping receipt and monthly statement of securities held must be provided to the City.

VII Competitive Selection of Investment Instruments

When purchasing or selling securities, the Treasurer shall select the security which provides the highest rate of return within the parameters of these policies and according to the current objectives and needs of the City's portfolio. The Treasurer, at his discretion, may purchase investments through the investment or trust department of the City's primary bank without soliciting proposal forms to other banks or broker/dealers. The City Treasurer may also purchase investments using a competitive process by soliciting proposals from the financial dealers in the "Qualified Institutions" list.

If a specific maturity date is required, either for cash flow purposes or for conformance to maturity guidelines, bids will be requested for instruments, which meet the maturity requirement. If no specific maturity is required, a market trend (yield curve) analysis will be conducted to determine which maturities would be most advantageous. Selection by comparison to a current market price may be utilized when, in the judgment of the Treasurer, competitive bidding would inhibit the selection process.

VIII Reporting

The Treasurer shall submit quarterly investment reports to the City Council that summarizes recent market conditions, economic developments and anticipated investment conditions. The report shall summarize the investment strategies employed in the most recent quarter and describe the portfolio in terms of investment securities, maturities, risk characteristics and other pertinent features. The report shall explain the quarter's total investment return and compare the return on LAIF and the 3-month bank CD rate published by the Federal Reserve. The report shall disclose all transactions during the quarter.

**CITY OF LAGUNA HILLS
INVESTMENT AND PORTFOLIO POLICIES
2018**

As part of the City's annual audit, the independent auditor shall evaluate investment performance and conduct an operations audit. The purpose of these examinations shall be to obtain suggestions for improved future performance, and to verify that the Treasurer has acted in accordance with this investment policy and written investment procedures.

IX Annual Investment Policy and Adoption

The City's investment policy shall be annually reviewed and adopted by resolution of the City Council of the City of Laguna Hills, California. The policy and the related internal control procedures shall be reviewed annually by the City's independent auditors, and any modifications to the policy must be approved by the City Council.

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